

CHARITABLE REMAINDER TRUST



Charitable Remainder Trust (CRT) — A Custom Income Gift Solution

An issue many generous people face is how to make gifts while providing for oneself or the needs of one's family. Gifts that return income present one possible solution, as they simultaneously generate income for the donor and family while supporting a cause important to the donor. The **charitable remainder trust** is the most flexible and versatile type of these gifts (the other type being charitable gift annuities), allowing donors to customize income to their needs and convert illiquid assets into a new stream of income.

Setting Up a New CRT

CRTs are standalone legal entities, and are usually established with the help of an attorney who advises on the endless trust and payout options available and who can customize the trust to the donor's goals and needs. The IRS publishes sample trust language for qualified charitable trusts in several variations. In establishing the trust, the donor must decide:

1. The trustee and charitable beneficiary that will receive the remainder funds. The trustee is usually a bank or financial institution, but is also sometimes a charitable organization or even the donor themselves. The donor can name more than

one charitable beneficiary, and reserve the right to change charitable beneficiaries.

2. The people to receive income, deciding if they should receive income for a term of years or for life, and deciding if income shares are concurrent or sequential.
3. The type of income: whether the CRT pays out a fixed percentage (minimum 5 percent) of its value annually, called a **unitrust (CRUT)**, or pays out a fixed dollar amount annually, called an **annuity trust (CRAT)**. Alternatively, the trust can pay out the lesser of net income or a fixed percentage, called a **net income unitrust**, which can have the ability to make up payments for prior years in which only net income was paid. Unitrusts can take multiple donations and are suitable for illiquid assets like real estate. Annuity trusts can only be funded once and should only be funded with readily sellable assets.
4. The timing of the income: either the income starts immediately, called a **standard trust**, or the trust pays only net income until the sale of the illiquid asset or other future triggering event, called a **flip unitrust**, where it converts from a net income unitrust to a standard unitrust.

While there are no state-of-residency requirements, donors incur modest legal expenses to establish the trust along with annual maintenance expenses paid by the trust.

Benefits of Charitable Remainder Trusts

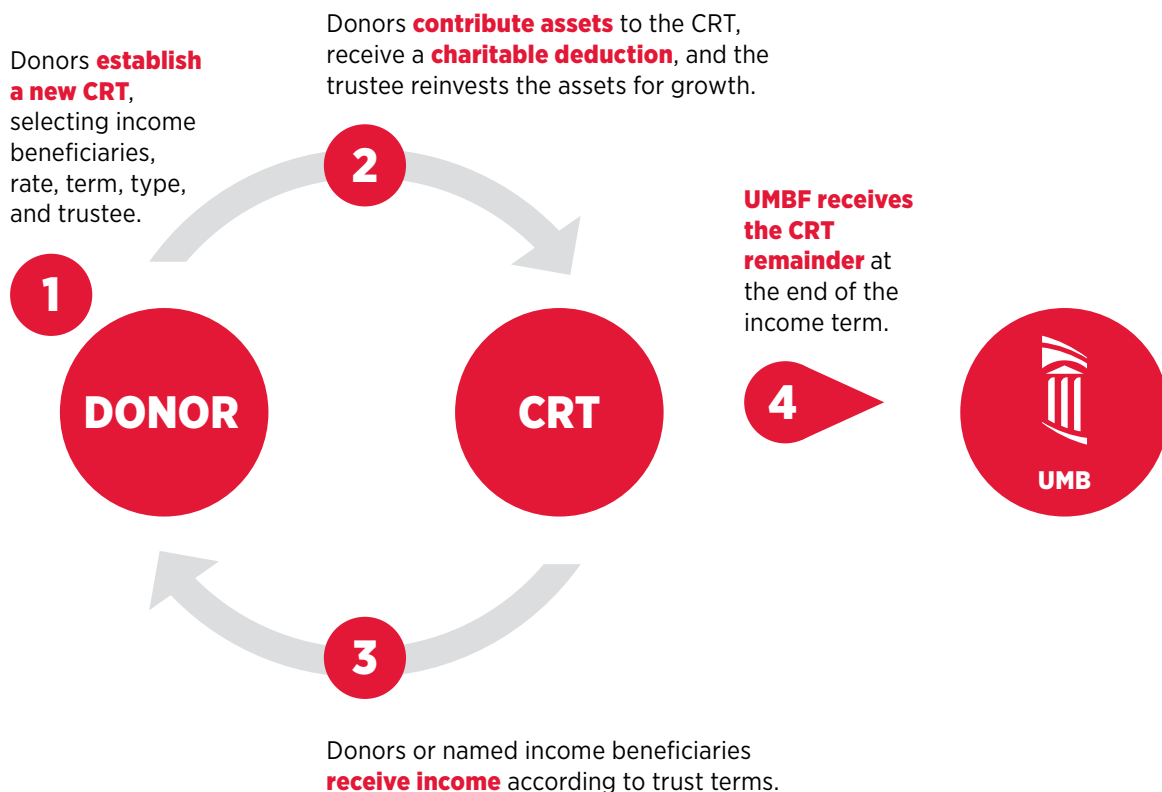
The reasons donors establish charitable trusts include:

- Donors receive a charitable deduction equal to the calculated remainder value of the trust. The deduction amount is inversely proportional to the amount of income paid out by the trust. The longer the income, and the higher the income, the lower the deduction. Likewise, having multiple income beneficiaries or younger beneficiaries would lower the deduction. Trusts must generate a deduction of at least 10 percent or more of their face amount to qualify as a charitable trust.
- Donors avoid recognizing capital gains upon transfer of assets into the trust, which means CRTs represent a tax-efficient way to convert highly appreciated stocks and other assets into a tax-efficient stream of income. CRT income is taxed according to a four-tier system, in which all ordinary income is taxed first, followed by long-term

capital gains (LTCG) income, tax-exempt income, and return of principal. Thus, while the donor would pay LTCG tax on CRT payments as they are received, the sale itself is untaxed and the full amount is put to work within the trust. The trustee can invest the assets in ways to manage taxes on future payments.

- When donors own assets that produce little or no income, donating them to a CRT can increase current spendable income and augment retirement income from other sources. If the income is not needed until a later date, the donor can design the trust to pay the lesser of net income or 5 percent until the donor reaches a certain age, after which time the trustee starts to pay a fixed 5 percent of the trust value for the rest of the donor's life. A strategy like this maximizes three things: the future payments to the donor, the future remainder gift to charity, and the immediate charitable deduction.

CRT Diagram—How It Works



Comparison: Unitrust vs. Annuity Trust—Beneficiaries age 71 & 71 receiving joint lifetime income

Beneficiaries age 71 & 71 receiving lifetime income	5% Unitrust	5% Annuity Trust
Initial contribution	\$100,000	\$100,000
First year income	\$5,000 (variable)	\$5,000 (fixed)
Income in years 2+	5% of principal value annually	\$5,000 annually regardless of principal value
Charitable deduction†	\$42,822	\$32,665
Estimated lifetime income*	\$104,054	\$95,000
Estimated gift to UMBF*	\$120,811	\$133,760

† Based on a discount rate of 3%

* Assumes annual net investment growth of 6% and income payments ending in 19 years

The Flip Unitrust

While charitable trusts are ideally funded with assets that can be readily sold, the flip unitrust is worth considering for those with real estate or assets with uncertain sale amount and timing. So that the trust is not stuck having to pay income without available cash on hand, the donor designs the trust to pay out only net income (which might be zero) until a “triggering event” happens, which could be the sale of the illiquid asset. Other triggering events might be a marriage, the birth of a child, the sale of a business, or any other event that is partially or entirely out of the donor’s control. After the triggering event, the CRT converts into a standard unitrust paying a fixed percentage of assets every year to income beneficiaries.

Glossary: Charitable Remainder Unitrusts

CRUT = charitable remainder unitrust: a trust that pays variable income determined by a fixed percentage of annual principal value

CRAT = charitable remainder annuity trust: a trust that pays a fixed dollar amount regardless of principal value

NICRUT = net income charitable remainder trust: a CRUT that pays the lesser of a predetermined percentage or net income; may include a makeup provision to compensate for low income years, called a NIMCRUT

Flip CRUT = flip charitable remainder trust: a trust that behaves like a NICRUT before a triggering event, and flips to a standard CRUT after a triggering event; commonly used with real estate and illiquid assets

Income term = either the lifetime(s) of the income recipient(s) or a term of years not to exceed 20

Payout rate = minimum is 5 percent, maximum is determined by the MRI according to the current Section 7520 rate

Section 7520 rate = discount rate set monthly by the IRS, used to calculate deduction for remainder value

MRI = minimum remainder interest: CRTs must have a calculated remainder charitable interest of at least 10 percent to qualify as a charitable trust

Sample CRT documents issued by the IRS can be found at: www.irs.gov/irb/2005-34_IRB

This publication is not intended to provide legal, tax, investment, or other professional advice, and should not be relied upon for such advice. In advance of any charitable gift plan, we encourage you to seek the advice of legal, tax, and investment professionals.

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